No. 4091

IN THE

United States Circuit Court of Appeals

For the Ninth Circuit

J. J. RAUER,
Appellant,

vs.

GEORGE H. HATFIELD, as trustee in bankruptcy of the estate of A. E. Buckman, bankrupt, and H. M. Wright, et al.,
Appellees,

and

J. J. RAUER,
Appellant,

vs.

GEORGE H. HATFIELD, etc., et al.,
Appellees.

BRIEF FOR APPELLANT.

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Statement of Facts.

The two appeals here presented by the defendant and appellant Rauer are from two judgments entered against him—one being a judgment in favor of the plaintiff, Hatfield, as trustee of the Estate of A. E. Buckman, a bankrupt, against Rauer for

the sum of $13,023.19 and interest, and the other judgment is against Rauer for $1,800.00 and in favor of H. M. Wright, Master in Chancery, as compensation for services in the litigation resulting in the first judgment above referred to.

Very briefly stated, the facts giving rise to the litigation are as follows:

In 1910, and for some years prior thereto, A. E. Buckman was engaged in the business of street contracting in the City and County of San Francisco, and had become largely indebted. In 1910 he caused a corporation to be formed, known as the Sunset Construction Company, and afterwards, in 1911, Buckman organized and caused another corporation to be formed also known as the Sunset Construction Company. This second company was organized because the first company had lost its franchise on account of non-payment of taxes. There was no other reason for the incorporation of the second company in 1911, and the books and property and assets of the old company were turned over to the new company, and it was agreed by the officers of the new company that the certificates of stock issued in the old company should stand and be evidence of ownership of the same number of shares in the new company. The new corporation had a president, secretary and manager and in every way functioned as a corporation. Buckman was the owner of all the shares other than those issued as qualifying

shares to the directors and the corporation was dominated by him.

In 1914, a judgment was obtained against Buckman in the sum of $15,000.00, being damages for breach of promise of marriage. Shortly after the judgment was obtained, namely, on February 19, 1915, Buckman filed a voluntary petition in bankruptcy, listing as his creditors those who had claims against him arising out of matters other than the transactions with the Sunset Construction Company. None of the creditors of the Sunset Construction Company filed any claims against the bankrupt estate, nor was any notice sent to those who had dealings with the Sunset Construction Company, and a nominal bond in the sum of $100.00 was given by the trustee elected by the creditors, who were limited, as before stated, to those who had done business with Buckman individually.

In 1911 Rauer, who was engaged in the business of lending money, made advances to the corporation known as the Sunset Construction Company, and continued to advance large sums thereto until after October 27, 1915, the date of the filing of the complaint in this action.

The physical property belonging to and standing in the name of the corporation was of comparatively small value and the business followed by the corporation was the taking of contracts for street work and the completion of the same by the aid of money advanced by different people, and especially by the

defendant, Rauer. At the time of making the advances the lender would take an assignment of the money payable under the contracts by way of security for his loans.

On January 15, 1914, the Sunset Construction Company was indebted to Rauer in the sum of $20,000.00 for moneys so advanced by him and on that date Buckman, gave Rauer his note, secured by 10,150 shares of the capital stock of the corporation, as additional security for the advances. These shares represented practically all of the shares of stock issued by the corporation, and were evidenced and represented by a certificate which had been issued by the first corporation formed. As before stated, no certificates evidencing shares of stock were issued by the new corporation, it being arranged by the corporation that the certificates of shares of stock in the old corporation should be deemed evidence of ownership of the same number of shares in the new.

Rauer had no personal acquaintance with Buckman prior to 1911 and Rauer knew nothing whatever about the fact of there being two different corporations formed or of any agreement about the certificates of shares of the old corporation being evidence of the ownership of the shares of stock of the new corporation and Rauer had no knowledge or notice of any kind that he was not dealing with a corporation functioning in the usual way.

Rauer continued to make advances to the corporation after the filing by Buckman of his petition in bankruptcy in the same manner that he had made advances to the corporation during the three or four years prior to that time. Rauer had no knowledge that Buckman had filed a petition in bankruptcy and had no knowledge that the filing of a petition by Buckman in bankruptcy at all affected in any wise the Sunset Construction Company, the corporation with whom he was dealing. Rauer presented no claim against the bankrupt estate, nor did he recognize Buckman in any wise as his debtor excepting on the note given by Buckman for an indebtedness of the Sunset Construction Company and which note was secured by a pledge of Buckman of all the shares of stock of the Sunset Construction Company. These shares, which were of no market value, were subsequently sold by Rauer under a pledgee sale for an insignificant sum. Rauer had also taken from the corporation by way of security for advances, a chattel mortgage on some personal property consisting of machinery and the like, and also a mortgage on some real estate belonging to the corporation, and, as before stated, Rauer would take an assignment of contracts at the time he would advance money to the corporation to carry on the work required to be done on the contracts, and collected moneys on the contracts assigned to him as security for the re-payment of said moneys, just as he had been in the habit of doing for years prior

to the filing by Buckman of his voluntary petition in bankruptcy.

Some eight months after the filing of the petition in bankruptcy, the trustee in bankruptcy commenced this action. As we read the complaint, the action proceeds upon the idea that the transfer of the shares of stock by Buckman to Rauer was made for the purpose of delaying and defrauding the creditors of Buckman. The complaint also contains an allegation that Buckman caused the corporation to be formed for the purpose of concealing the identity of said Buckman under the form and legal entity and name of said corporation, and that the organization amounted to nothing more than the placing in a corporate form the capital of said Buckman and his abilities as a general construction contractor. The complaint does not allege that Rauer had any knowledge of the purposes for which Buckman had organized the corporation, and, so far as the allegations of the complaint are concerned, in reference to charging against Rauer, it is limited to the charge that Rauer participated in the transfer made in January, 1914, to him by Buckman of the shares of stock in the corporation, which is alleged to be fraudulent.

It should be added that the Master in Chancery finds that on February 19, 1915, the day upon which Buckman filed his petition in bankruptcy, the corporation was owing to Rauer the sum of $18,746.22. And thereafter, because of advances made to the

corporation, the corporation became further indebted to Rauer in the sum of $18,561.54, making in all the sum of $37,307.76, owing to Rauer for loans made to the corporation, upon the security of the physical property mortgaged as aforesaid, and upon the assignments made to him of moneys payable under contracts for the completion of which Rauer had advanced moneys.

The judgment in the case proceeds upon the theory that the Sunset Construction Company was, in legal effect, none other than Buckman; that on the day the petition in bankruptcy was filed by Buckman, Rauer was a creditor, not of the corporation, but of Buckman, in the sum of $18,746.22; and that Rauer must account for and pay to the trustee the full amount of all sums collected by Rauer after February 19, 1915 for street work performed by the Sunset Construction Company prior to that date and without regard to whether the moneys so paid to Rauer under the street work contracts were assigned to Rauer prior or subsequent to February 19, 1915 for moneys owing by Sunset Construction Company to Rauer.

And concerning the sums of money advanced by Rauer to the Sunset Construction Company after February 19, 1915, in good faith as found by the Masters and amounting to the sum of $18,561.54, the Master refuses to have taken into account in any way whatever, and does not even make the suggestion that Rauer present a claim

therefor to the bankrupt estate, which suggestion he does make concerning the $18,746.22 found by the Master to be owing to Rauer by the Sunset Construction Company on February 19, 1915, and the assets of which bankrupt estate consists of nothing but the claim against Rauer, involved in this action.

Rauer, as mortgagee of the machinery used in the doing of street had rightly taken possession thereof under the terms of the chattel mortgage, and had made use of the machinery and had credited the value of this use against the mortgage indebtedness. The Referee and the final judgment disallow this method of accounting for the value of the use of the machinery and adjudge that Rauer must pay the full amount of the value of this use to the trustee, although the amount of the indebtedness for which the machinery was security was largely in excess of the value of the property mortgaged, after crediting against the same the full amount of the value of the use of the mortgaged property.

There are no assets of any kind pertaining to the bankrupt estate except such as may result from the payment to the trustee by Rauer as the result of this action, and it appears that the personal indebtedness of Buckman, not incurred in any wise in connection with the affairs of the Sunset Construction Company, is over $100,000.00. The disastrous consequence to Rauer from

such a theory of accounting is, of course, most apparent, and the Master in Chancery spoke most conservatively when he said in his report concerning the application of the above theory:

> "There are, of course, difficulties arising out of the fact that the company was never declared a bankrupt; that its creditors have not been scheduled or notified to file their claims, and the defendant Rauer will suffer loss by reason of the fact that he believed himself entitled to deal with the company after Buckman's bankruptcy as a separate entity, not affected by his bankruptcy. These, however, are matters that concern the correctness of the interlocutory decree only, and so far as Rauer is concerned, I shall hereafter embody a recommendation that he be allowed to prove his claim herein."

The foregoing facts present the main contentions in the case. The other facts are addressed to some matters of accounting which will arise, assuming that the plaintiff's construction of the interlocutory decree, is correct.

The transcript also contains a statement of the facts upon which appellant claims the report of the Master should be set aside, on the ground that the Master was disqualified to act judicially in the matter of making his report, and which report was adopted by and confirmed by the judgment.

By an interlocutory decree, the matter of an accounting was referred to the Master. The Master filed his report and, at the same time, filed a petition to be allowed $5,000.00 for compensation. In this

petition the Master recites that the action is brought by a trustee in bankruptcy and that there were no assets of the estate other than the claim against Rauer. The record shows that unless a judgment is awarded against Rauer, there is no fund out of which the Master can be paid the $5,000.00 compensation which he asks, and the petition for compensation filed by the Master sets forth that such is the fact.

We do no suggest that the Master was consciously affected by this circumstance in the making of this report finding against Rauer. We simply call attention to the facts and assert that the law absolutely prohibits a man from acting judicially in a matter in which he can be affected financially by the character of the judgment he renders.

There are two appeals here presented on one record by appellant, J. J. Rauer, this procedure being authorized by order of Court (transcript page 426). These appeals are:

First: The Appeal from an Interlocutory Decree Directing an Accounting and Referring the Accounting to H. M. Wright, as Master in Chancery, and from the Final Judgment Disallowing Appellant Rauer's Objections to the Report of the Master and Entering Judgment Pursuant to the Report.

Second: The Appeal From the Order or Decree Allowing to H. M. Wright, as Master, a Certain Sum of Money for Compensation and Di-

RECTING THE SAME BE PAID BY APPELLANT, J. J. RAUER.

The record is quite lengthy, and to our minds a great part thereof has little or no bearing on the questions involved in these appeals. It shall be our endeavor to present, or call attention in this brief, to all parts of the record essential to a correct determination of the questions involved in the appeal. This purpose may add to the number of pages under this cover but it is hoped it will make for a great saving of time and labor on the part of the Court.

Specifications of wherein the decrees and orders appealed from are alleged to be erroneous.

Appellant contends that the decrees appealed from are erroneous in the following particulars:

As to the specifications wherein the interlocutory decree is alleged to be erroneous—

First. Assuming that the interlocutory decree is construed as adjudging that Rauer conspired with Buckman in a scheme to incorporate the Sunset Construction Company as a means whereby Buckman could defraud his creditors, the decree is erroneous for the following reasons:

(a) There is no evidence whatever to support such a decree.

(b) A decree to the effect above stated is entirely outside of any issue raised by the pleadings.

(c) There was no creditor defrauded.

Second. Assuming that the interlocutory decree is construed as adjudging that the shares of stock of the Sunset Construction Company pledged to Rauer were the property of the plaintiff as trustee of Buckman, the decree is erroneous for the following reasons:

(a) There is no evidence whatever to support such a decree.

(b) Assuming that there is evidence to support the decree that the plaintiff is the owner of the shares of stock, the decree is erroneous in not providing that such ownership in the trustee claiming under Buckman is subject to the lien in favor of Rauer for the sums of money owing to Rauer and for which the shares were pledged by Buckman as security.

As to the specifications wherein the final decree is alleged to be erroneous:

(a) The said decree is erroneous in adopting and ratifying the report of H. M. Wright as master, as the record before the Court before the signing of the said final decree established the fact that the said H. M. Wright would be financially affected by the judgment entered in accordance with his suggestions and recommendations in his report and that he would suffer financial loss if the judgment were entered in favor of the defendant Rauer, and of which fact the said Master, H. M. Wright, was cognizant at the time of the making and of the

submission by him to the Court of his said report which was so adopted and embodied in the final decree.

(b) The said final decree is erroneous in determining that the sums of $9321.59 and $3701.60, or any sum of money, was owing at the time of said decree or at the time of the filing of the complaint herein by said Rauer to the plaintiff as trustee of said Buckman, a bankrupt.

(c) The said final decree is erroneous in adopting and confirming the report made by the master and which report proceeds upon the contention that the interlocutory decree determines that Rauer must account to the plaintiff as trustee of Buckman for all transactions with the corporation, the Sunset Construction Company, as if he were a party to the formation and operation of said corporation and for the purpose of defrauding the creditors of Buckman.

(d) The final decree is erroneous in not recognizing and giving effect to the pledgee lien in favor of Rauer in the sums of money in which the shares of stock of the Sunset Construction Company were pledged to him.

(e) The said final decree is erroneous in not giving any effect to the fact that Rauer at all times dealt with the Sunset Construction Company without any knowledge that the said corporation was a cloak by which Buckman should defraud his creditors, if such were the fact.

(f) The said final decree is erroneous in not giving any effect to the findings of the Master that Rauer at all times transacted business with the Sunset Construction Company in good faith and in the full belief that he was authorized to transact business therewith.

(g) The final decree is erroneous in not giving effect to the pledgee sale of the shares of stock pledged by Buckman to Rauer.

(h) The final decree is erroneous in not allowing the right of set-off to Rauer of the amount owing from the Sunset Construction Company to Rauer at the time of the filing of the petition in bankruptcy by Buckman; and the final decree is erroneous in refusing to take into account the transactions between the defendant Rauer and the Sunset Construction Company and of the money advanced to or paid out by Rauer for the Sunset Construction Company, after February 19, 1915, and prior to the making of the interlocutory order or the filing of the complaint.

(i) The final decree is erroneous in adopting the master's report wherein it is stated that the money owing to Rauer at the time of the filing of the petition in bankruptcy by the Sunset Construction Company was $18,746.32, whereas, in fact, the evidence shows there was a much larger sum owing at said time from said corporation to Rauer.

(j) The final decree is erroneous in adopting the master's report and adjudging that Rauer must

account to plaintiff in the sum of $4016.20, and which item is the subject of Exception 13 of the Exceptions filed by the defendant Rauer to the final judgment and is set forth on page 405 of the record.

(k) The final decree is erroneous in adopting the master's report in adjudging that Rauer must pay to the trustee in bankruptcy the sum of $9016.99 for the rental value and use after February 19, 1915, of the equipment and personal property of the Sunset Construction Company mortgaged to Rauer, and which item is the subject of Exception 14 of the final decree found on page 405 of the record.

(l) The final decree is erroneous in adopting the master's report refusing to allow the rental value of the said machinery charged to the defendant Rauer as a credit on the mortgage indebtedness due Rauer and secured by pledge on the said machinery.

(m) The said final decree is erroneous in adopting the master's report in refusing the defendant Rauer the cost of repairing the personal property so used by Rauer and in not allowing the said Rauer to have credit upon his said mortgage indebtedness in the amount of said advances as embraced in Exception 16 to the final judgment to be found on page 407 of the transcript.

(n) The final decree is erroneous in adopting the master's report charging Rauer $5381.79 as

gross profits received from the contract between the Federal Construction Company and the Sunset Construction Company about January, 1915, which is the subject matter of Exhibit 17 on page 407 of the transcript.

(o) The said final decree is erroneous in adopting the master's report based upon the erroneous construction of the interlocutory decree and which is embraced in Exception 18 of the assignment of errors found on page 408 of the transcript.

(p) The final decree is erroneous in adopting the master's report and decreeing the sum of $3701.60 on deposit in the matter of the bankrupt estate and belonging to Rauer should be retained by the plaintiff and the payment thereof made to said Rauer by credit upon the indebtedness so adjudged as owing by the said Rauer to the plaintiff, and which is the subject matter of Exception 18, assignments of error, page 408 of transcript.

(q) The final decree is erroneous in finding there is due from the defendant Rauer to the plaintiff trustee the said sum of $3701.60 now in the possession of the Court and belonging to the defendant Rauer and the sum of $9321.59, and which is the subject matter of Exception 20, contained on p. 409 of transcript.

And the appellant now specifies the following particulars in which the order allowing compensation to the master, H. M. Wright, is erroneous and from which order an appeal was taken, as appears by the

record, page 379 of transcript; and said order so appealed from is erroneous in the following particulars:

(a) It appears from the said record that the said master, H. M. Wright, was acting judicially in the making of the said report which was adopted by the final judgment in the case, and that the said master was financially interested in the character of said report and was aware at the time of making said report that he would be affected adversely financially by a suggestion or report or judgment in favor of the defendant Rauer; and therefore he should be allowed no compensation, as his services were of no value.

(b) Assuming the Master is entitled to any compensation, the said order is erroneous in not reducing the sum of $5000 demanded by the said Master for his services in making said report to a sum not to exceed the sum of $750, and the Court erred in allowing the sum of $1800 for said services.

ARGUMENT.

FIRST: THE APPEAL FROM AN INTERLOCUTORY DECREE DIRECTING AN ACCOUNTING AND REFERRING THE ACCOUNTING TO H. M. WRIGHT, AS MASTER IN CHANCERY, AND FROM THE FINAL JUDGMENT DISALLOWING APPELLANT RAUER'S OBJECTIONS TO THE REPORT OF THE MASTER AND ENTERING JUDGMENT PURSUANT TO THE REPORT.

The argument in support of this first appeal under the foregoing heading will be presented under the following heads:

a. A discussion of the issues presented by the complaint and by the answer; and the interpretation and scope of the interlocutory decree.

b. The objection that the interlocutory order or decree is not sustained by the evidence.

c. Objections to the final judgment disallowing appellant's objections to the report of the Master and the entry of judgment pursuant to the report.

A: A Discussion of the Issues Presented by the Complaint and by the Answer; and the Interpretation and scope of the Interlocutory Decree.

That the Court may appreciate the significance of the evidence and the pleadings as bearing upon the construction of the decree, it is perhaps best to state at the outset the contention of the defendant Rauer as to the meaning of the interlocutory decree, and then the contention of the counsel for appellees as to its construction, and which latter construction was adopted by the Master. It should be added that if the construction contended for by defendant Rauer is upheld, concededly no judgment would pass against him upon an accounting. On the other hand, if the construction sought by plaintiff is correct, there are exceptions to the specific findings in the Master's report, which findings appellant claims are entirely unsustained by the evidence.

The contention of the defendant Rauer is that the action was brought to have it declared that the trustee in bankruptcy was the owner of all the shares of

stock in the Sunset Construction Company, a corporation, on the ground that all the shares (excepting shares to qualify directors) had been issued to A. E. Buckman, and that the transfer by Buckman to Rauer of these shares was done to hinder and delay the creditors of Buckman and hence the transfer was void; that the plaintiff as the trustee in bankruptcy of A. E. Buckman as the owner of all the shares of stock in the corporation, was entitled to an accounting of all transactions between Rauer and the corporation. It is the contention of the defendant Rauer that the pleadings and the decree recognized the existence of the corporation, the Sunset Construction Company, referred to in the complaint, which is the Sunset Construction Company which was organized on the 12th day of December, 1911.

The position taken by the plaintiff is that the litigation did not proceed to determine the ownership of the shares of stock referred to in the complaint and that the shares of stock legally had no existence, and that an accounting should be had between Rauer and the trustee in bankruptcy as if there were no corporation Sunset Construction Company, and as if Buckman, the bankrupt, and no one else was transacting business with Rauer.

With this brief statement of the diverse views of the plaintiff and defendant, Rauer, as to the purposes of the action and the meaning of the decree, we will proceed and present our argument as to which interpretation is the correct one.

A decree of a Court, like any other writing, should be interpreted in view of the circumstances leading to its making.

> "The rule for construction of ambiguous judgments is clearly stated by the Supreme Court of Kansas in the following language:
>
> 'Wherever the entry of a judgment is so obscure as not to clearly express the exact determination of the Court, reference may be had to the pleadings and other proceedings; and if, with the light thus thrown upon such entry, its obscurity is dispelled and its intended signification made apparent, the judgment will be upheld and carried into effect in the same manner as though its meaning and intent were made clear and manifest by its own terms'" * * *
>
> (Black on Judgments, 2nd Ed. Vol. 1, Sec. 123, p. 179.)

The only matters that legally could have been in the mind of the Court at the time the decree was made, or which should have at all affected the making thereof, are the following:

> First. The pleadings before the Court, consisting of the complaint and the answer.
>
> Second. The evidence that was introduced by the parties, and the admissions made by the parties during the trial, and the remarks of counsel and of the Court during the hearing.
>
> Third. The abstract propositions of recognized law, governing the determination of the issues as presented by the pleadings and by the evidence and upon which the interlocutory decree was based.

We will therefore discuss in the foregoing order these matters which alone could have entered into

the mind of the Court at the time of the making of the decree, or could have been the basis thereof.

FIRST: THE PLEADINGS BEFORE THE COURT, CONSISTING OF THE COMPLAINT AND THE ANSWER.

The pleadings consist of the bill in equity and the answer thereto.

The complaint alleges in paragraphs I and II the formal allegations setting out that on the 19th day of February, 1915, the defendant, A. E. Buckman, filed his voluntary petition in bankruptcy, and on the same day was adjudged a bankrupt. The remainder of the complaint is as follows:

> Paragraph III. That defendant Sunset Construction Company was organized as a corporation under the laws of the State of California, on the 12th day of December, 1911; that said corporation was formed and organized by defendant, A. E. Buckman, for the purpose of carrying on a general contracting and construction business. That said corporation was formed and organized as a cover for the activities and operations of said A. E. Buckman, and for the purpose of concealing the identity of said A. E. Buckman under the form and legal entity and name of said corporation. That said A. E. Buckman immediately became the owner of all of the outstanding, subscribed shares of the capital stock of said corporation, with the exception of two shares issued, one each, to defendant Wm. H. Chapman, and one J. Maury, for the purpose of incorporation, and said A. E. Buckman ever since has owned all of said outstanding subscribed capital stock, and ever since has completely owned, operated

and managed said corporation for his sole benefit. That the organization and formation of said corporation amounted to nothing more, and has amounted to nothing more, than the placing in a corporate form of the capital of said Buckman and his abilities as a general construction contractor.

Paragraph IV. That said defendant, Wm. H. Chapman, is and has been since the formation of said Sunset Construction Company, the President thereof, and defendant, Filmore Buckman, is and has been since the formation of said Corporation the Secretary thereof.

Paragraph V. That in January, 1914, defendant, A. E. Buckman, delivered and transferred to defendant J. J. Rauer all of the capital of said corporation, the Sunset Construction Company, owned by said A. E. Buckman; that said delivery and transfer was without consideration and was made by said A. E. Buckman in contemplation of insolvency, and left said Buckman without sufficient funds or property to meet his debts and obligations then due and owing, and was made with intent to hinder, delay and defraud the creditors of said A. E. Buckman and said creditors were thereby hindered, delayed and defrauded.

Paragraph VI. That at some time subsequent to January, 1914, the exact date of which is unknown to plaintiff, said defendant J. J. Rauer delivered and transferred to defendant John Doe Meadows the shares of said capital stock delivered and transferred to said Rauer by said A. E. Buckman, as hereinbefore alleged. That said transfer from defendant A. E. Buckman to defendant Rauer, and from defendant Rauer to defendant Meadows was made as the result of a conspiracy and agreement between defendants A. E. Buckman, Rauer, Chapman, Filmore Buckman, and Meadows to hinder, delay and defraud the creditors of defendant

A. E. Buckman and to withhold from them the shares of the capital stock of said Sunset Construction Company owned by said A. E. Buckman, and to retain for themselves the management, operation, benefits and profits of said corporation. That neither said Rauer nor said Meadows paid or gave any consideration whatsoever for said shares, but accepted said shares with intent to aid and abet in hindering, delaying and defrauding the creditors of said A. E. Buckman, and with full knowledge of the intent of said A. E. Buckman to hinder, delay and defraud his creditors. That said Meadows now holds said shares upon a secret trust for the benefit of said defendants A. E. Buckman, J. J. Rauer, Wm. H. Chapman, Filmore Buckman and himself. That said A. E. Buckman, J. J. Rauer, Wm. H. Chapman, Filmore Buckman and John Doe are now, and ever since January, 1914, have been operating and carrying on said corporation and its business for the benefit of each of them and receiving the profits thereof.

Paragraph VII. That the estate in Bankruptcy of A. E. Buckman, bankrupt, is insufficient to pay or satisfy the claims against said estate, unless said shares of the capital stock of the Sunset Construction Company, and the assets of said corporation be subjected to the payment of said claims and considered as part of said estate in bankruptcy. That the verified schedule of said bankrupt filed with his said petition in bankruptcy discloses unsecured debts and obligations amounting to a sum in excess of $150,000.00 to meet which there are no assets of said estate.

Wherefore, plaintiff prays:

1. That he be declared to be the owner, as trustee in bankruptcy of A. E. Buckman, of said shares of the capital stock of the Sunset Construction Company.

2. That it be decreed that the attempted transfer of said shares from said A. E. Buckman to defendant J. J. Rauer, and from said Rauer to said defendant John Doe Meadows be declared null and void and of no force or effect.

3. That said defendants A. E. Buckman, Rauer, Chapman, Filmore Buckman and John Doe Meadows be directed to deliver to plaintiff said shares and the assets, properties, books, contracts of said Sunset Construction Company, and the management and control thereof.

4. That an accounting be had from said defendants of the assets and profits of said corporation since the month of January, 1914.

5. For such other and further relief as may be proper and equitable, and for costs herein. (Trans. pp. 3 to 7.)

The answer to the bill in equity, speaking broadly, denies all matters alleged in the complaint as a cause of action, and then sets up affirmatively:

"Defendants allege that the facts concerning the disposition of any shares of stock owned or controlled by the defendant, A. E. Buckman, were as follows:

On the 15th day of January, 1914, the Sunset Construction Company was indebted to the defendant, J. J. Rauer, in the sum of $20,000.00 for and on account of the moneys loaned by said defendant, J. J. Rauer, to the said Sunset Construction Company, and for the better protection and security of said J. J. Rauer for said sum of money so loaned, as aforesaid, the defendant, A. E. Buckman pledged to the said J. J. Rauer, 10,150 shares of the capital stock of the said Sunset Construction Company on said 15th day of January, 1914; thereafter and on the 12th day of August, 1914, the said defendant J. J. Rauer sold said 10,150 shares of the capital

> stock of the Sunset Construction Company to satisfy in part the indebtedness to him of the Sunset Construction Company and said stock was sold for the sum of $50.00 to H. Wehrle, and thereafter the said H. Wehrle sold and transferred said 10,150 shares of stock to the defendant J. A. Meadows, sued herein as defendant, John Doe Meadows, and said J. A. Meadows ever since the sale to him of said shares of stock has been the owner and holder thereof." (Trans. pp. 8 and 9.)

The answer then alleges various transactions between Rauer and the Sunset Construction Company, setting out that the first transaction commenced on the 9th day of March, 1911, and setting forth somewhat in detail the several accountings had between Rauer and the Sunset Construction Company, and also setting up that on the 16th day of June, 1914, the Sunset Construction Company by resolution of its Board of Directors thereunto duly authorized, gave H. Wehrle a personal property mortgage covering all the personal property of the Sunset Construction Company to secure the payment of a promissory note dated said 16th day of June, 1914, for the sum of $5,000.00, and to cover further advances, and said personal property mortgage was duly acknowledged by said Sunset Construction Company on the 16th day of June, 1914, and said personal property mortgage was accompained or had attached thereto an affidavit of all the parties thereto to the effect that it was made in good faith and without any design to hinder, delay or defraud creditors, and that said personal property mortgage was

recorded on the 3rd day of July, 1914, in the office of the County Recorder of the City and County of San Francisco, State of California, in Liber 70 of Personal Property Mortgages, at page 388. And that on the 18th day of June, 1914, the said H. Wehrle advanced to the said Sunset Construction Company the sum of $10,000, which sum was secured by the aforesaid personal property mortgage under the terms and conditions thereof. That the personal property mentioned in the aforesaid personal property mortgage is of the market value of $5,000.00, or thereabouts, and that said Sunset Construction Company had no other property at the date of the filing of the bill herein, and other than its open book accounts and interests in contracts, said corporation had no other property for a long time prior to the filing of the bill herein, and the said shares of stock of said Sunset Construction Company had no market value at the time of the sale thereof by the said J. J. Rauer to foreclose the pledge thereof, as aforesaid.

Counsel for plaintiff in the briefs in the lower Court placed great stress upon the closing paragraph of allegation VI of the complaint, which is as follows:

> "That said A. E. Buckman, J. J. Rauer, Wm. H. Chapman, Filmore Buckman, and John Doe Meadows are now, and ever since *January 1914,* have been operating and carrying on said corporation and its business for the benefit of each of them and receiving the profits thereof."

Counsel contends that this paragraph is equivalent to an allegation that there was no corporation, and that Rauer is a party to the fraudulent scheme to make use of the so-called corporation as a mask whereby Buckman can cheat and defraud Buckman's creditors.

We first call attention to the fact that nobody else than these men named in the paragraph had any connection with the corporation as stockholders, directors, officers, pledgees, creditors, or otherwise, and we inquire to whom else should any profits arising from the operation of the corporation go, or who other than some of these men should carry on the affairs of the corporation. The corporation had no creditors other than Rauer, which is probably explainable by the fact shown by the record and to which attention will hereafter be called, that the large sums owing to Rauer by the corporation was used to pay the obligations incurred by the corporation.

We wish to stress particularly the following facts:

That the complaint alleges that the corporation was formed by Buckman in 1911 as a cloak "for his activities". There is no suggestion in the complaint that Rauer even knew Buckman prior to January, 1914, much less that he conspired with Buckman to form a corporation on the 12th day of December, 1911; and it will be observed that the date

January, 1914, set out in paragraph V of the complaint as the date at which Rauer is alleged to be carrying on the business of said corporation with Buckman and the others, is the date at which in the complaint Rauer is charged to have fraudulently purchased the shares of stock without consideration from Buckman in order to defraud the creditors of Buckman.

If these men were guilty of a premeditated fraud, how can one account for the fact that Rauer is the lone creditor of the corporation, and this to the sum of over $37,000? In the name of common sense, why should Rauer engage in such a transaction? As the transcript shows, no evidence was introduced in support of such a theory of the complaint, and fraud is never presumed. The evidence shows that the Sunset Construction Company had officers—a president, secretary, and board of directors, and in all the transactions between Rauer and the corporation, Rauer was acting on one side, and the corporation acting through its officials on the other side. Resolutions were regularly adopted and presented to Rauer, showing the officers' authority to act for the corporation in its dealings with him. Rauer had no knowledge that the corporation was not authorized to function, or that its transactions were otherwise than perfectly legal, and as found by the Master, Rauer fully believed that he was "entitled to deal with the company after Buckman's bankruptcy as a separte entity not affected by his

bankruptcy." (Master's Report, page 63 Transcript.)

The only fraud charged against Rauer in the complaint is in paragraphs V and VI in reference to the acquisition of the shares of stock.

And we now set out the interlocutory decree:

> "This cause came on to be heard at this term, and was argued by counsel; and thereupon, upon consideration thereof, it was ordered, adjudged and decreed as follows, viz.:
>
> 1. That A. E. Buckman at all times, and up to and on the 19th day of February, 1915, was the owner of all the issued and outstanding capital stock of the Sunset Construction Company, a corporation, and that on said last mentioned day said stock vested in and became, and now is, the property of R. Cords, Jr., as trustee of the estate of A. E. Buckman, bankrupt.
>
> 2. That A. E. Buckman at all times, and up to and on the 19th day of February, 1915, was the owner of the Sunset Construction Company, a corporation, and all of the property, books, and records of said company and that on said last mentioned day said company, property, books and records vested in and became, and now are, the property of R. Cords, Jr., as trustee of the estate of A. E. Buckman, bankrupt, and that said property be held by said Cords pending an accounting between said company and defendants A. E. Buckman, J. J. Rauer, Filmore Buckman and Wm. H. Chapman.
>
> 3. That defendants A. E. Buckman, J. J. Rauer, Filmore Buckman, and Wm. H. Chapman severally account for all moneys or property received by them from, or advanced by them to, defendant Sunset Construction Com-

pany since the 12th day of December, 1911, whether such transactions were made in the names of third persons or in the names of said parties for the purpose of determining what claims, if any, exist between said company and said persons.

4. That for the purpose of taking said above-mentioned accounting said cause be referred to H. M. Wright, Master in Chancery of this Court, to take and examine said account and report thereon to this Court.

Dated, September 11th, 1916.

Wm. C. Van Fleet,
Judge of the District Court of the United States for the Northern District of California."

(Tr. pp. 15 and 16.)

We will next discuss the second matter which affected the Court in the making of the interlocutory order.

SECOND: THE EVIDENCE THAT WAS INTRODUCED BY THE PARTIES, AND THE ADMISSIONS MADE BY THE PARTIES DURING THE TRIAL, AND THE REMARKS OF COUNSEL AND OF THE COURT DURING THE HEARING.

This evidence is directed simply and solely to the question of the ownership of the shares of stock pledged by Buckman to Rauer, and by Rauer sold under the pledge to Meadows, the trustee claiming these shares should pass to the estate, and the defendants insisting that the sale was made under a valid pledge. (Transcript pages 209-239.)

It is also claimed by the plaintiff that there had been no valid pledge of the shares to Rauer or sale

to Meadows because there had been an earlier corporation, called the Sunset Construction Company, composed of the same individuals, composing the Sunset Construction Company which was incorporated on the 12th day of December, 1911, and that the directors of the earlier corporation failed to pay the license tax and the corporation's rights to do business lapsed, and the officers of the second corporation did not issue new certificates of stock in the second corporation, but proceeded upon the idea that the certificates of stock issued in the first corporation might be deemed and regarded as the issues of stock in the second corporation. It may be added that the second corporation agreed that the holders of stock in the first corporation should hold the same number of shares of stock in the second corporation. (Transcript pages 224-5.) The certificates in the new corporation, duplicating the certificates in the old, were actually prepared and signed by the officers of the new corporation, but were not torn out of the stockholders or in physical form delivered to the holders of the stock. On page 224 transcript, W. H. Chapman, the attorney for the corporation and president thereof at the time, makes this explanation of the transaction:

> "Originally, the corporation forfeited its charter sometime in December for non-payment of taxes, and we contemplated, when we incorporated, the issuance of the certificates shown in the books that are filled out but not signed by the secretary, to be issued in the place of the old certificates, and the same number of shares issued to the directors of the defunct Sunset

> Construction Company as trustees for the corporation, the 10,000 and odd shares; we afterwards learned that what we had done in reincorporating was practically a redemption of the right to act, and we went ahead then, just as though there had been no forfeiture, and considered the old certificates as valid certificates of the corporation.
>
> We did not issue any new certificates; only in lieu of cancelled certificates of the old corporation, all of these that are in here were to take the place of the old certificates, but they are still here, the same number of shares."

There is no suggestion of any kind that Rauer knew anything whatever about the matter of the issuance of the shares of stock in the second corporation, or that he ever knew there was a first and second corporation, or that he ever knew anything of the interior workings of the corporations, as to who were the stockholders thereof, or who were the directors thereof, or when the corporations were organized, or anything at all about their doings, beyond the fact that there was a concern doing business as a corporation, of which Mr. Buckman and the other directors were the representatives, and that Buckman was the owner of shares of stock in that corporation, which had been pledged by him to Rauer.

His dealings with the corporation were only as a man who lent money to the corporation, taking as security therefor in one instance a pledge of the shares of the corporation owned by Buckman, and in another instance a mortgage on personal prop-

erty owned by the corporation, and when advancing money on specific contracts, taking assignments of the same by way of security for the moneys so advanced. There was no evidence presented at the trial before the District Court except on the issue as to who owned these shares of stock, pledged by Buckman to Rauer, and as to whether the plaintiff was entitled to recover those shares of stock as belonging to the estate of the insolvent Buckman; and in connection with this matter, we call attention to the transcript on page 231, from which we quote:

> "Mr. RAUER testified:
> I am the man to whom Mr. Buckman pledged 10,150 shares of the stock of the Sunset Construction Company. That pledge was made in January, 1914 by a pledge note and the stock was then delivered to me. I have here a copy of that note.
> The COURT. All you are litigating now is the ownership of the stock, I suppose?
> Mr. LANE. The ownership of the stock, and it is my contention that there has never been any valid pledge of this stock."

(Mr. Lane was the attorney for the plaintiff trustee.)

Close at the end of the testimony at the trial, and just prior to the testimony of Rauer as to the sale of the pledged stock, and which testimony was the only evidence upon which the interlocutory decree was based (transcript page 233), the Court expresses very tersely his understanding

of the proposition that is at issue in the case. We quote the Court:

> "The COURT. I am not going into an accounting of that kind. *My theory of this case is that if this stock belongs to Buckman, a decree will go to that effect, and an accounting will be had; otherwise, I do not care anything about it.* He admits that he (Rauer) simply holds it as a pledge that it never was sold to him, that it was simply assigned to him. *The only question is, whose property was it? If it was Buckman's property, they will be entitled to a decree, and then an accounting as to the present rights will be had before a master.*"
>
> (This is before Rauer's testimony as to the sale of the stock by him.)

It is submitted that the decision of the Court that the shares of stock pledged by Buckman to Rauer, and by Rauer sold to Meadows, belonged to Buckman, and therefore passed to the trustee in bankruptcy at the time of the adjudication of Buckman a bankrupt, is not based on the ground there was any fraud in the matter of the pledge of these shares by Buckman to Rauer.

> "The COURT. All you are litigating now is the ownership of this stock, I suppose?"

The complaint in the case, as we have said before, proceeded upon the idea that Buckman was the owner of these shares, and that he made a transfer of these shares for the purpose of defrauding his creditors. The evidence shows that the shares were pledged to Rauer some time in January, 1914. They were sold under a pledgee sale August 12, 1914.

There is not a scintilla of evidence in the record that the pledge was not for value as testified to by the parties, and it is not reasonable to assume that the Court found contrary to the evidence. In other words, there is no evidence whatever to support the allegations of the complaint that the sale of these shares was made by Buckman in January, 1914, to defraud his creditors in the bankruptcy proceedings, which were instituted shortly after the judgment against Buckman for breach of promise of marriage, referred to later on in this record, and the language of the interlocutory decree in this respect is quite significant. The decree does not find that the sale made by Buckman of the shares of stock referred to in the complaint was fraudulent and therefore should be set aside. The decree simply adjudicates that the trustee in bankruptcy of Buckman is the owner of these shares. The transaction between Buckman and Rauer in relation to the shares in January, 1914, was a pledge and not a sale, and concerning the fairness of the transaction the evidence does not admit of a doubt, and the decree does not find any fraud. The decree simply adjudicates that the trustee is the owner of the shares. Such a judgment is fully consistent with the validity of the pledgee interest in Rauer. It is true the judgment does not give recognition or effect to the pledgee sale divesting Buckman of all ownership in the shares. Whether recognition was denied on the ground in the opinion of the Court a valid pledgee sale could not be made because of

irregularity in the issuance of the certificates evidencing the ownership of the shares or because the sale was made for such a trivial sum that the Court was disposed to view it as void for lack of notice or otherwise does not appear.

If the pledgee sale be regarded as void then of necessity the pledgee interest in Rauer must be given effect, and the amount of the pledge indebtedness must be given priority to any ownership by the trustee.

Attention is again called to the fact that the complaint only asks for an accounting from January 1914, the date alleged in the complaint as the date of the alleged fradulent sale of the shares of stock by Buckman to Rauer.

It is significant that the Court in its decree does not find even in the most distant way that Rauer was a party to any fraud. In this case no certificates of stock in the new corporation were actually delivered to Buckman, and this upon the understanding testified to by Mr. Chapman that the shares of stock issued in the old corporation should stand as the shares of stock in the new, and because of this non-issue it was contended that the so-called pledge sale of Rauer's did not transfer Buckman's shares to the purchaser, and the title remained in Buckman, subject to an equitable pledge in favor of Rauer. This is in accordance with the theory advanced by Mr. Lane that there was no legal pledge of the shares of stock. No wrongful intent can be ascribed to Rauer to take

over these shares of stock belonging to Buckman, and thereby obtain a value in these shares which would defraud the creditors of Buckman from participating in that value. The record is peculiarly significant in showing that the entire controversy, so far as the evidence shows, was directed to the ownership of these shares, which were deemed of value, and being so deemed it was sought by the trustee to have them declared the property of the bankrupt estate.

It may be added that the evidence on the accounting shows, and the Master so in effect finds, that these shares were absolutely of no value, so far at least as the interest of the corporation or the trustee is concerned.

We wish to emphasize that Rauer is before this court with clean hands. There is no question of his good faith or his belief that he had the right to deal with the Sunset Construction Company, as a separate entity, and that he was not a party or privy in any wise to any scheme, if such there were, on the part of A. E. Buckman to use the Sunset Construction Company as a means whereby Buckman might defraud his creditors. The fact found by the Master that Rauer is a creditor of the Sunset Construction Company in a large amount, conclusively establishes this fact, aside from all the other evidence.

While fraud will never be presumed (and there was no evidence whatever showing Rauer to be guilty of any fraud), yet we do not have to rely

upon any presumption. The Master on transcript page 63, speaking of the judgment he suggests should be rendered against defendant Rauer says:

> "There are, of course, difficulties arising out of the fact that the Company was never declared a bankrupt; that its creditors have not been scheduled or notified to file their claims, and the defendant Rauer will suffer loss by reason of the fact that he believed himself entitled to deal with the company after Buckman's bankruptcy as a separate entity, not affected by his bankruptcy. These, however, are matters that concern the correctness of the interlocutory decree only, and so far as Rauer is concerned, I shall hereafter embody a recommendation that he be allowed to prove his claim herein."

In view of the fact that there are no assets of any kind pertaining to the estate of the bankrupt, except only this alleged claim against Rauer, and in view of the fact that there are claims against the bankrupt estate, which including the judgment for damages for breach of promise of marriage against Buckman, amount to considerably over $100,000.00, this recommendation of the Master that Rauer be allowed to file a claim against the bankrupt estate of A. E. Buckman personally, is most illusive. If it were not a judicial utterance we would say it was ironical.

But, we ask, what creditors of Buckman have been injured by Rauer's dealings, or have a right to complain? For theoretically at least it is only to the extent that they were injured by the whole sum by Rauer's dealings that the court should be

asked to afford relief; and this brings us to the question of who are these creditors who are claimed to have been injured by Rauer, and to what extent have they been injured?

This action is brought by a trustee in bankruptcy and, of course, he simply represents the creditors. All of the creditors who filed their claims in the bankruptcy court, were creditors in the transactions with Buckman personally, and not arising out of any business matters with the corporation, the Sunset Construction Company, and all claims filed in the bankruptcy court arose out of transactions prior to the formation of either Sunset Construction Company No. 1 or Sunset Construction Company No. 2, except only the claim of the woman who obtained a judgment against Buckman for $15,000.00 for breach of promise of marriage. This claim was obtained in 1914, and this judgment for breach of promise of marriage was the cause which led to the filing by Buckman of his petition in bankruptcy.

The record shows, and it is so found, that Rauer knew nothing about the fact that there were two Sunset Construction Companies. He knew nothing whatever about the fact, if it be a fact, that Buckman organized the corporation for the purpose of a cloak under which to do business.

No creditor of the Sunset Construction Company, much less Rauer, ever filed a claim in said bankruptcy, nor was any creditor of the Sunset Construction Company scheduled as a creditor of

Buckman personally, or notified to present any claim against the bankrupt estate of Buckman.

The evidence shows that the Sunset Construction Company had a complete organization, a president and a secretary, and that the secretary was very active in its affairs; that it had books of account, and that all transactions between Rauer and the Sunset Construction Company recognized the existence of the Sunset Construction Company, and in no wise did Buckman have any personal dealings with Rauer in connection with the affairs between Rauer and the Sunset Construction Company; and the accounts upon which the Master makes his report are accounts shown on the books of Rauer and the books of the Sunset Construction Company, to be transactions between Rauer on the one side and the Sunset Construction Company on the other. There can be no question that Rauer in his dealings with the Sunset Construction Company, instead of impairing the fund and the property, out of which any creditors of Buckman might have their demands satisfied, enlarged the same. And it cannot reasonably be contended that there is any basis for any assertion that Rauer in his dealings with the Sunset Construction Company attempted to defraud anybody, or that as a matter of fact his dealings with the Sunset Construction Company impaired the resources of Buckman personally to pay any debts that Buckman personally owed, as the Master found that on February 19, 1915, the Sunset Con-

struction Company was justly indebted to Rauer in the sums of $18,746.22 and later, as we have seen, the Sunset Construction Company became further indebted to Rauer in the additional amount of $18,561.54, thus making a total of $37,307.76.

This action is being prosecuted by the assignee of Buckman. In view of the fact that Rauer in good faith dealt with the Sunset Construction Company as a separate entity, and was not a party to any fraud, if any existed on the part of Buckman, the plaintiff as the assignee of Buckman is entitled to no greater rights as against Rauer than Buckman would be entitled to.

Let us concede for the sake of argument that there was no Sunset Construction Company, as a matter of fact: that it had not even filed articles of incorporation. Nevertheless, Buckman in his dealings with Rauer held out that there was such a corporation as the Sunset Construction Company. Rauer believing such to be the case, had transactions with the supposed corporation, the Sunset Construction Company.

Under the foregoing circumstances, Buckman would be estopped from saying as against Rauer that there was no Sunset Construction Company, and that the machinery and assets which Buckman said belonged to the Sunset Construction Company was the property of Buckman personally. Surely, Buckman would be so estopped, and if Buckman would be estopped, wherein does Buckman's as-

signee have any greater rights or stand in a different position?

Let us assume for sake of argument, that the Sunset Construction Company was simply an agent or instrument by which Buckman as an undisclosed principal transacted business.

Rauer had no knowledge of this relation of principal and agent, and had an absolute right to an accounting against the agent as if the agent were in fact a principal.

If a creditor discovers that a person with whom he has been transacting business as a principal is in fact an agent, the law allows the creditor at his option to proceed against the hitherto undiscovered principal.

Full credit must be given to the creditor for all transactions with the agent prior to the discovery of the undisclosed principal.

Basically, the plaintiff's cause of action is predicated upon the theory that the creditors whom he represents have been wronged by Rauer in that Rauer has depleted the fund to which the creditors had the right to look for payment. When it is borne in mind that the claims of these creditors arose prior to the formation of the Sunset Construction Company and prior to the advent of Rauer on the scene in connection with the Sunset Construction Company, and that Rauer by virtue of his dealings with the Sunset Construction Com-

pany added to its property to the extent of $37,307.76, in excess of anything he received from the Sunset Construction Company, it follows that Rauer, instead of depleting the fund has contributed most largely thereto, and there is no basis for the claim of these creditors.

It will be borne in mind that in the evidence introduced before the Court, upon which the interlocutory decree is based, it was shown that Buckman had pledged equitably, if not legally, with Rauer 10,050 shares of the capital stock of the Sunset Construction Company as security for the payment of a promissory note of $20,000.00, and no attack is made upon the fact that these shares of Buckman were pledged to Rauer for money of that amount advanced by Rauer. It appeared afterwards that Rauer made a sale of these shares of stock under his right as pledgee for $50.00. By this sale the Court says in effect the legal title to these shares, which was in Buckman, was not transferred, but of the validity of the pledge itself there is no question. (And it might also be remarked that the Sunset Construction Company being largely indebted at that time the stock had but a nominal value.)

If the pledgee sale was ineffective, then the title of Buckman did not pass, but his interest in the stock, of course, is subject to the lien for the sum of money for which the shares were pledged, and no right could pass to the assignee in bankruptcy,

except the right of Buckman. Therefore the pledgee of these shares is entitled to the payment of the indebtedness for which the shares were pledged before any part of the value of these shares could pass to the assignee of Buckman.

There being a pledge, the plaintiff, as trustee of Buckman, would not be entitled to the shares, whether there was a pledgee sale or not, except subject to the lien for which the shares were pledged. The report of the Master does not recognize this pledge.

We have now taken up the pleadings, and we have taken up the evidence, and we will now take up the third head, which is:

THIRD: THE ABSTRACT PROPOSITIONS OF RECOGNIZED LAW, GOVERNING THE DETERMINATION OF THE ISSUES AS PRESENTED BY THE PLEADINGS AND BY THE EVIDENCE, AND UPON WHICH THE INTERLOCUTORY DECREE WAS BASED.

A. The fact that the certificates of stock were not physically issued and delivered by the second corporation in accordance with the rights of the stockholders to have them issued, did not in any wise affect the status of the persons entitled to the shares of stock as stockholders in the corporation.

B. The Sunset Construction Company, being apparently a corporation transacting business was for all purposes a *de facto* corporation, and no inquiry is open as to whether the corporation had complied with all forms prescribed by the statute.

C. The decree legally could not go beyond the issues raised by the pleadings, and the

only issue raised by the pleadings or alluded to in the evidence was the question of the ownership of the shares of stock.

D. The interlocutory decree is not sustained by the evidence if plaintiff's construction thereof be correct.

A. The fact that the Certificates of Stock were not Physically Issued and Delivered by the Second Corporation in Accordance with the Rights of the Stockholders to have them Issued, did not in any wise affect the Status of the Persons Entitled to the Shares of Stock, as Stockholders in the Corporation.

We quote the following California cases:

"To constitute the subscribers to an agreement for the formation of a corporation stockholders of the corporation, it is not necessary that the certificates of stock should have issued to them."

San Joaquin Land etc. Co. v. Beecher, 101 Cal. 70; 35 Pac. 349.

"The issuance of a certificate of corporate stock is not a necessary preliminary to the ownership or assessability of such stock."

Pacific Fruit Co. v. Coon, 107 Cal. 447, 40 Pac. 542.

"Issuance of certificate of stock for stock subscribed and paid for is not necessary to constitute one a stockholder or owner of shares in a corporation."

Hughes Mfg. & L. Co. v. Wilcox, 13 Cal. App. 22; 108 Pac. 871.

It will be remembered that the shares of stock referred to in the complaint and of which shares

plaintiff trustee alleges he has been deprived by a fraudulent sale to Rauer by Buckman in January, 1914, are shares of stock in the new corporation organized December 12, 1911. This corporation is the second corporation and no certificates of stock were issued in this new corporation pursuant to the agreement that certificates of shares in the old corporation should represent a like ownership in the new corporation.

B. The Sunset Construction Company, being Apparently a Corporation Transacting Business was for all purposes a de facto Corporation, and no Inguiry is open as to whether the Corporation had Complied with all the Forms Prescribed by the Statute.

If the Sunset Construction Company was doing business as a corporation, it was not incumbent upon Rauer to examine its articles of incorporation, or to see that its by-laws were properly enacted, or to see that its license tax was paid, or to see that the requisite number of shareholders had voted for its officers, or see that it conformed to the regulations of the statute. In other words, if it were an association of persons holding themselves out as a corporation, a person can transact business with that assemblage as such, and the matter is not open for inquiry as to whether it is a *de jure* corporation.

Today a very great volume of business is done through corporations, and how could it be deemed reasonable that before a person could do business with a corporation, he would be obliged to see that

it had been regularly incorporated, and had followed all the forms prescribed by the statute.

We quote from a few of the cases:

(Clarke on California Corporations)

"If the corporation claims in good faith to be legally incorporated and is doing business, it is sufficient.

"A corporation de facto may legally do and perform every act and thing which the same entity could do or perform were it a *de jure* corporation. As to all the world except the paramount authority under which it receives its charter, it occupies the same position as though in all respects valid, and even against the state except in direct proceedings to arrest its usurpation of power, it is submitted its acts are to be treated as efficacious."

(Pages 64-65.)

And again supra, p. 68-69, and cases cited:

"What is a corporation de facto? It exists when a number of persons have organized and acted as a corporation; have put on the habiliments of a corporation; have assumed the form and features of a corporation; have conducted their affairs to some extent, at least, by the methods and through the officers usually employed by corporations; have assumed the appearance, at least, of the counterfeit presentment of a legal corporate body. Quo warranto is the proper and only proceeding to test the right to a franchise to exist, or to procure a judgment of its forfeiture."

Of course, in the instant case, the pleadings allege the incorporation of the Sunset Construction Company No. 2. It is made a party defendant in

the suit, and all the pleadings and the evidence are directed towards the manner in which it functioned. There is no question that it was a de facto corporation, and to our mind there is no question that it was a de jure corporation, but whether a de jure corporation or not, it certainly was a de facto corporation, and being such it is a legal entity, and its existence must be recognized.

C. The Decree Legally could not go beyond the Issues raised by the Pleadings, and the only Issue raised by the Pleadings, or Alluded to in the Evidence was the question of the Ownership of the Shares of Stock.

It is elementary that a judgment cannot go beyond the issues raised by the pleadings. We have pointed out that neither by the pleadings, nor the evidence, was there any suggestion of any matter being before the court, except as to whether the shares of stock at one time owned by Buckman, and pledged to Rauer, and sold by him under the pledge to Meadows belonged to the trustee as representative of the Buckman estate. The only issue tendered was whether a transfer made by Buckman of these shares was in fraud of his creditors, and the *only relief sought* was to have it declared by the court that the transfer was in fraud of creditors, and have it adjudged that these shares of stock belonged to the trustee, as representing the insolvent estate (Transcript pp. 6-7), and there was no evidence upon any other point.

Great stress is laid by counsel for plaintiff on the fact that the shares of stock in the old corporation,

Sunset Construction Company No. 1, were used and viewed as shares of stock in the Sunset Construction Company No. 2, and it is contended that there was no issuance of shares of stock in Sunset Construction Company No. 2, and it is argued that if no pieces of paper were issued, evidencing holding of stock in Sunset Construction Company No. 2, there could be no owner of shares of stock in Sunset Construction Company No. 2. It will be borne in mind that Rauer did not know of the existence of the two corporations, and that the existence of these two corporations was discovered by the parties to this suit, or by the attorney for the plaintiff, only at the time of the trial of the case. It will be borne in mind also that the ownership of shares of stock in the corporation does not depend upon the issuing of a piece of paper evidencing that ownership. The further fact also must not be forgotten, that the property acquired by the Sunset Construction Company No. 2 was by virtue of a transfer from Sunset Construction Company No. 1, and the only consideration for the transfer was that the holders of the shares of stock in the Sunset Construction Company No. 1 should be the stockholders in the Sunset Construction Company No. 2 in the same proportion as they were in the Sunset Construction Company No. 1. No other consideration moved in the matter of the transfer. Logically it might be urged that if the issuance of pieces of paper marked shares of stock in Sunset No. 2 were an essential before one could own shares

of stock in No. 2 then no property of any kind belonged to Sunset No. 2 because the only consideration passing to Sunset No. 1 for the transfer to Sunset No. 2 of all the property it possessed was shares of stock in Sunset No. 2, and hence there would be no consideration. And the further fact must also be borne in mind that Sunset Construction Company No. 2 had no assets of any kind except the property transferred to it by Sunset Construction Company No. 1. The corporation referred to in the complaint is a corporation incorporated on the 12th day of December, 1911, (see paragraph III, page 3 of transcript), and which corporation is corporation No. 2. But we repeat, the evidence showed that Rauer had no knowledge that there were two corporations or that the certificate of shares which was pledged to him was of the shares of stock in Sunset Construction Company No. 1, and it will not be forgotten that it was not until the trial of this case that it was discovered by Rauer and by the plaintiff that there had been two corporations.

Rauer, for valuable consideration, advanced money, the payment of which was secured by a pledge by Buckman of the shares of the Sunset Construction Company, which Buckman represented to be a valid issue, and Rauer, having acted in good faith and on the strength of these representations, Buckman would be estopped from making any statement that his representations were not

true, and likewise his assignee, the plaintiff in this suit, would be estopped.

It seems clear to us that the foregoing proposition is correct. But we would not have to rest this proposition on the ground of estoppel. If Buckman were entitled to the shares of stock, whether they were issued or not, would not affect his right. The issuance of the certificate would be simply evidence of that right, but the right could be established otherwise. There is no question it was designed that the shares of stock in the old corporation should be considered the shares of stock in the new, and this would suffice; especially as the only claim that the Sunset Construction Company No. 2 could have to any of the property possessed by it was the fact that it was transferred to it upon consideration that the shareholders in the old corporation should be shareholders to the same extent in the new; and when it is borne in mind that Rauer did not know there were two corporations and did not know that the shares of stock so pledged to him had not been issued in the new corporation, this right of Rauer should not be questioned.

Having now reviewed the pleadings, the evidence and the propositions of law applicable to the facts and the pleadings, we come to the consideration of the decree itself. Paragraph 1 of the decree refers to the shares of stock of the Sunset Construction Company; paragraph 2 recites that Buckman "was the owner of the Sunset Construction Company, a

corporation, and of all the property, books and records of said company, and that on said last mentioned day said company, property, books and records vested in and became, and now are the property of R. Cords, Jr., as trustee of the estate of A. E. Buckman, bankrupt." It is contended that the language of this second paragraph is equivalent to a decision that the Sunset Construction Company never existed as a corporation. It must be conceded that the language of this second paragraph is not legally precise. One cannot be the owner of a corporation. We think the language should be construed as meaning that since Buckman was the owner of all the shares of stock in the corporation, that in equity he would be considered the owner of the property of the corporation, and if Buckman were such owner, then his trustee in bankruptcy would succeed, and might in a broad sense be called the owner of the corporation. The language cannot be taken literally, and a construction should be given in harmony with the first paragraph of the decision. If this second paragraph be contrued as determining that there was no corporation and that the litigation does not concern the shares of stock, then the judgment is otuside of the issues. Further, there being no evidence whatever before the Court to justify a judgment that Rauer was a party to any fraud with Buckman in the formation of the corporation to be used as a mask to defraud Buckman's creditors, the decree should not be construed

as making such a determination, if another construction can be given which is consistent with the evidence and justified by the pleadings. Why insist upon a construction which is entirely unsustained by the evidence or warranted by the pleading?

D. The Interlocutory Order or Decree is not Sustained by the Evidence, if Plaintiff's Construction Thereof be Correct.

We have heretofore discussed the pleadings and the evidence and the terms of the decree and interlocutory decree for the purpose of showing that the decree should be construed as a determatination relative the ownership of the shares of stock in the corporation. That the decree should not under the issues raised by the pleadings and the evidence before the court and the terms of the decree itself be construed as an adjudication that Rauer was a party to a fradulent scheme concocted by Buckman, whereby Buckman, under the cover of a corporate name transacted business from the time of the formation of the corporation for the purpose of defrauding his, Buckman's creditors.

During the discussion we have referred to the evidence upon which the interlocutory decree was based with the thought that thereby a proper construction of the decree would be aided. We have contended there was no issue before the Court except only as to the ownership of the shares, and that the evidence indicated that to that question the attention of the Court was directed. We now submit that under the evidence presented to the

Court, and upon which the interlocutory decree is based, there is no evidence whatever warranting any decree that the shares of stock were fraudulently transferred by Buckman to Rauer or that Rauer was a party to any fraudulent conspiracy with Buckman whereby Buckman was enabled under the cloak of the corporation, the Sunset Construction Company, to defraud his creditors. There is not to our mind a scintilla of evidence to support either conclusion. Fraud is never presumed. It must be proved. The plaintiff is simply a trustee of Buckman, and has no greater rights.

The testimony upon which the interlocutory decree is based is very short and the remarks of the trial judge very illuminating. We earnestly ask the court to read the same. (Trans. pp. 209 to 238.)

It will be remembered that the trustee in bankruptcy was selected by those persons who were creditors of Buckman personally. That no creditor of the Sunset Construction Company participated in the selection of the trustee or filed a claim against the estate. That the trustee in bankruptcy sent out no notice of any kind to any creditors of the Sunset Construction Company but only to those creditors who were creditors of Buckman personally. It will be borne in mind that the adjudication in bankruptcy was brought about by voluntary petition by Buckman following a judgment of $15,000.00 obtained against Buckman by an irate female for breach of promise of marriage; that in no wise did

the trustee in bankruptcy so much as suggest to any person dealing with the Sunset Construction Company they were doing so at their peril, and not until the filing of this complaint was the thought ever brought forward that those who were transacting business with the Sunset Construction Company were in law transacting business with Buckman, a bankrupt.

The Master in his report finds that

> "Rauer will suffer loss by reason of the fact that he believed himself entitled to deal with the Company after Buckham's bankruptcy as a separate entity, not affected by his bankruptcy. These, however, are matters that concern the correctness of the interlocutory decree only, and so far as Rauer is concerned, I shall hereafter embody a recommendation that he be allowed to prove his claim herein." (Transcript, page 63.)

It does not require the report of the Master to establish that Rauer believed he could legally transact business with the corporation. The judgment against Rauer proceeds upon the idea that for the money he advanced to the corporation in good faith before the filing by Buckham of his petition in insolvency, and which had not been previously repaid, Rauer would get a percentage of the debt upon presenting his claim to the trustee in bankruptcy, and would get nothing for what he had advanced afterwards. And it will be borne in mind that Rauer had no knowledge of any kind that Buckman had filed a petition in bankruptcy, or had been adjudicated a

bankrupt, much less had he the knowledge that the adjudication in bankruptcy of Buckman was in law an adjudication in bankruptcy of the corporation, the Sunset Construction Company, with whom he had been transacting business amounting to thousands of dollars for many years before as well as after such adjudication.

Sunset Construction Company No. 2 was organized December 12, 1911; Buckman's bankruptcy was February 19, 1915, three years and two months later. But the theory now contended for by plaintiff is that Mr. Rauer and Buckman had organized Sunset Construction Company No. 2 in December, 1911, apprehending that in 1915, Buckman, one of the stockholders, might have a judgment for breach of promise of marriage rendered against him and be thereby forced into insolvency. And Mr. Rauer had advanced to Sunset Construction Company between those dates, even as the Master found, over $18,000.00, more than had been repaid to him.

Mr. Rauer had nothing whatever to do with the organization of the Sunset Construction Company or its internal affairs. See Filmore Buckman's testimony, transcript pp. 299-300, and Rauer's, pp. 301-3, and A. E. Buckman's testimony, pp. 305-6.

It will be borne in mind that the trustee in bankruptcy stood by and permitted Rauer to advance these subsequent moneys in the full belief by Rauer that the transaction was with the Sunset Construction Company. It will be remembered that for every

dollar Rauer so advanced the trustee is enriched to the extent of probably 99c as 1% on the dollar is probably the amount of the dividend that the creditors of Buckman would receive, and it will further be borne in mind that the only source from which any dividend would be paid to the creditors of Buckman personally are the assets of the Sunset Construction Company, created, enhanced and preserved by the money in good faith advanced by Rauer to the corporation both before and after the adjudication of Buckman's bankruptcy. And the trustee stood by and permitted Rauer to continue to pour his money into the corporation.

In view of these facts equity should certainly create an estoppel.

If the Sunset Construction Companys were not de juri corporations, but were only de facto ones, it must follow (as directed in the decree) that defendant Rauer's accounts with such de facto corporation must be first determined; and only if, after all the accounts between him and it are fully settled, and upon the final balance cast he owes the corporation anything, that for this, and this alone, would he be required to account to the trustee, as the owner of the stock. And if these corporations were not de juri corporations as plaintiff expressly alleges them to be, yet they would still be de facto corporations as far as defendant Rauer is concerned in the light of the Master's express finding that "defendant Rauer will suffer loss by reason of the

fact that he believed himself entitled to deal with the Sunset Construction Company after Buckman's bankruptcy as a separate entity not affected by his bankruptcy," and by every other fact shown by the evidence in this case.

All of the matters above set forth in relation to the basis for and meaning of the interlocutory decree are contained in the record (Transcript, pp. 209-238) and because these pages are so few and the matters so intertwined we have not made more specific references to the record.

OBJECTIONS TO THE FINAL JUDGMENT DISALLOWING APPELLANT'S OBJECTIONS TO THE REPORT OF THE MASTER AND THE ENTRY OF JUDGMENT PURSUANT TO THE REPORT.

The objections under this head are two-fold.

First: There is a general objection indicated by Exception No. VIII made by Rauer to the final judgment herein (see Transcript, page 400.) This exception is as follows:

> "The Master's said report, and the whole thereof, should be set aside and considered null and void, and the failure so to do is hereby assigned as error, and for the following reasons:
>
> That it appears from the record in this case that the action is prosecuted by a trustee in bankruptcy, who is not personally liable for the payment of any obligations beyond the extent of assets coming into his hands; that there are no assets of any kind belonging to the bankrupt estate, other than such as might result from

the judgment in this case. That this fact was known and recognized by the Master in his petition to be allowed the sum of $5,000.00 as compensation for his services in making the report. That in view of the fact that it appears by the record and by the statement of the Master himself in his petition for compensation herein, that only in the event of a judgment against the defendant Rauer, would he receive any compensation for his services, the record shows that he was financially affected by the character of the report he would file and by the judgment to be entered thereon, and therefore his report is void as being made by a judicial officer on a subject matter in which he had a financial interest, and the judgment and report filed herein being in favor of that interest."

The matters embraced in the foregoing exception are also embraced in the matter of the appeal from the judgment allowing the Master compensation, and at this time attention is simply called thereto. The matter will be more fully treated under the heading dealing with the appeal from the order allowing the Master compensation and directing the same be paid by Rauer.

The other objections to the final judgment in the matter of disallowing the objections to the Master's report and ordering judgment in pursuance therewith, relate to items in the account, and we will first take up the matters embraced in Exception XIV as stated on page 405 of the record. This exception is directed to the matter of the Master's report in reference to the findings charging Rauer

with the sum of $9,006.99, as the rental value of the machinery and plant mortgaged to him.

The machinery and property were mortgaged to Rauer in June, 1914, for the sum of $15,000 and future advances. This mortgage was in every respect bona fide and was so recognized by the Master in his report. By the terms of this mortgage, the mortgagee is entitled to possession upon default as to any portion of the sum secured thereby, and there being default, Rauer had taken possession of the property and used it in the performance of certain contracts. (Transcript pp. 364 and 44.) Quoting from the latter page, Master's report:

> "The chattel mortgage is in evidence, and covers certain named equipment and other property of the Company. It was accompanied by the necessary affidavits and was recorded. It contained a clause allowing the mortgagee to take possession after default. The notes were payable on demand, and since there was a continuing balance of indebtedness it is probable that a default occurred at an early date."

The property was of the value of $3,701.60 and the Master charges Rauer with the sum of $9,006.99 for the use of this property for a period of fifteen months. While we think the charge of $9,006.99 rental value is out of all reason, yet our main complaint is that Rauer is not allowed a credit for this alleged rental as against the mortgage indebtedness. The Master and the decree charge Rauer with this sum of money, and say he must pay this amount, dollar for dollar, and refuse to allow the same to be

taken into account in connection with the mortgage under which the property was in the possession of Rauer. Of course the mortgagee in the accounting should give credit to the mortgagor for the value of this use as against the mortgage indebtedness. The Master and the decree say he cannot, and that Rauer must pay the value of this use and cannot get credit therefor on his mortgage lien on this property. It is submitted that in this respect the Master and the decree are in error.

The machinery is of no value unless it is put to use. Unless it is put to use, it is a bill of expense. The bill of expense would not be so great as would be a bill of expense on a mortgage on live stock.

Let us assume that Rauer, instead of having a mortgage upon the machinery, had a mortgage on a number of mules, and under the terms of the mortgage was entitled to the possession. Could it be contended that it would not be the duty of Rauer to see that these mules were put to work if the opportunity offered so that thereby they would not eat their heads off, and that the mortgagor would acquire some return for the capital he had invested in his mortgaged property? What advantage would it be to the mortgagee to have possession of the property, if he could not have the use thereof, the use being the customary use to which the mortgagor would himself put the property. The use of the property would be an advantage to the mortgagor. The mortgagor thereby has an opportunity

to have his indebtedness decreased, to obtain interest upon his investment in the mortgaged property, and to save a large bill of expense running up for the storage on property which should be put to use. And it is submitted there is no difference in principle between the use of this machinery and appliances than there would be in the case of the above instance of a mortgage on live stock. Of necessity, there is wear and tear on the machinery by its use, and it cannot well be conceived that the mortgagee would permit the use of the machinery, thereby impairing his security, unless the value of the use would be credited on the mortgage indebtedness.

Further, the evidence shows that the trustee with full knowledge that the machinery was being used by Rauer made no objection thereto and in no wise indicated that the use was contrary to his desire, and Rauer made use of the machinery believing in good faith he had the right so to do and to have the value of the use applied in reduction of the mortgage.

If a trustee or pledgee has funds in his hands, it would be his duty to see that the money or property belonging to his pledgor brought in a return, and if a trustee in possession fails to utilize the trust property so as to earn something for the trustor, he would be charged with neglect.

We submit that Rauer was entitled to use this property under the terms of the mortgage, and being

so entitled, that the rental value goes to him as a part of his security. That he is obliged to account for his rental value only by giving credit therefor to the mortgagor upon the mortgage indebtedness.

The Master's report and decree confirming it not only refuse him the right to do this, but refuse him even the right to credit against these rentals, $2025.96 spent by Rauer in rebuilding and repairing this very property so that profit could be derived therefrom with the exception that the Master does allow him $148.43 for these repairs for the fifteen months use at the roughest kind of work, and for which the Master has charged him with rentals to the amount of $9006.99, and has even charged him with the scrap iron made up of the parts of the machinery which Rauer replaced. (Exceptions V, VI and VII, pp. 163-190 of transcript, embodied in objections to Master's Report and Petition, which plaintiff insisted should be a part of the transcript.)

There is no dispute of the fact that defendant Rauer took possession of the mortgaged property, and employed it and rented it out. Counsel in the lower court devoted pages to show this, and we equally affirm it as a fact. And counsel quoted with great approval the following from 11 C. J. 561.

> "While the right of redemption exists, a mortgagee in possession is liable to account for the income, profits and proceeds of the mortgaged chattel and, if the nature of the property permits, he is bound to exercise reasonable diligence in keeping it employed."

Just exactly what we claim, and just exactly what defendant Rauer did. He kept the property employed as much as possible. He collected rentals therefor and for every cent thereof he accounted by applying those receipts upon the indebtedness secured by this chattel mortgage; and none of counsels' citations, and none that he would possibly have found, require the mortgage to account in any other way. $9,006.99 of the $13,023.19 charged against defendant Rauer, is charged as such rentals. This is, however, some $2000.00 in excess of the gross profits or rentals collected by Mr. Rauer; and the net rentals collected are actually only $1838.56. (See Exception V, pp. 162-173, transcript.)

In order to keep the property employed, Mr. Rauer expended during this period of 15 months, for rebuilding, repairs and betterments, some $2800.00 and paid royalties on sand machine patents of $2,200.00, patents covering part of the said mortgaged machinery and necessarily used in connection therewith. (See said Exception V.) The master at first would not allow a cent of this on the ground that Mr. Rauer (the mortgagee) had no right to use or rent the property. And when on a subsequent hearing he became convinced of the erroneousness of this position, he would only allow $148.43 of these repairs because, as he said, Rauer had only actual written receipts for $148.43; although Rauer had produced his accounts thereof (which the Master would not consider upon the aforementioned

theory), and Rauer had substantiated those accounts by his testimony (transcript pp. 368-376), and a large portion thereof, also by the testimony of Fillmore Buckman. And this decision was made in the face of the fact that Mr. Rauer was charged with making collections of $9006.99 rentals during 15 months, from equipment worth $3701.60, used in the roughest kind of work, that everybody knows requires constant and expensive repairs and rebuilding.

And, as the Master found, on February 19, 1915, the date of Buckman's bankruptcy, the Company owed Mr. Rauer $18,746.22; and this was secured by the pledge of the stock and the chattel mortgage on all the equipment; and the Master charges that Mr. Rauer subsequently collected $13,023.19, $9006.99 of which was for rentals and use of the mortgaged property which had been taken possession of by Mr. Rauer. And this the Master charges Mr. Rauer had no right to apply upon the $18,746.22 secured by the mortgage upon this very property; nor that he had a right to credit against this the sum of $2800 for repairs and betterments which enabled him to so employ this property, nor some $2200 royalties for the use of the sand machine patents in connection with the use of said mortgaged property; and besides being charged with all profits and rentals he was charged with $1164.07 rentals on a job where he had made a loss of $945. (See Exception V, pp. 167-8 transcript, and Rauer's

testimony, p. 364.) And yet counsel claims that it was Mr. Rauer's duty to employ this mortgaged property so in his possession.

Then in the name of logic and common sense, was it not his duty to keep the equipment in the state of repair that would permit it to be employed? And is it then not his right to be allowed for all of these repairs and royalties he had to pay for that purpose? Our sense of right and justice and logic revolts at an allowance restricted to $148.43, whatever may be the pretext for such restriction.

To revert to the law upon this point, quoting from 11 C. J. 561 as follows:

> "While the right of redemption exists, a mortgagee in possession is liable to account for the income, profits and proceeds of the mortgaged chattels, and, if the nature of the property permits, he is bound to exercise reasonable diligence in keeping it employed."
>
> "But it has been held that he is chargeable for the usual hire only, and not for what was really made out of the use of the property."

We have shown in our Exceptions (trans. pp. 162-66), that the net rental upon this basis for which Mr. Rauer should have to account is only $883.66, instead of $9,006.99, charged against him by the Master.

Quoting further from 11 C. J., this time from page 562:

> "A mortgagee in possession of mortgaged property is entitled to be credited with all

> reasonable and actual expenses in caring for it, if he does not assume to hold in his own right and for his own uses, but as bailee or trustee for the mortgagor."

That Mr. Rauer held as bailee and trustee for the mortgagor is absolutely established by the fact that he credited the Sunset Construction Company upon its mortgage debt with every cent by him collected as rentals and for the use of this property. This citation further establishes that Mr. Rauer is entitled to be allowed for expenses for betterments and repairs amounting to over $2200.00, and for which the Master allowed him only the paltry sum of $148.43.

Quoting again from 11 C. J., this time from page 678:

> "A mortgagee in possession must devote rents and profits derived from the mortgaged property to the discharge of the mortgage debt, unless the mortgagor assents to a different appropriation."

And this is exactly what Mr. Rauer did, and this is what the Master's report confirmed by the decree states he had no right to do, and requires Rauer to account to the trustee for $9006.99 of rentals which he has already credited upon the indebtedness secured him by the chattel mortgage.

Exception XIII deals with the subject matter of the $4,016.20, which plaintiff insists is erroneously charged Mr. Rauer.

The error of charging Mr. Rauer with the $4,016.20 of the $13,023.19 (aside from the fact that this is purely and entirely an accounting between Mr. Rauer and the corporation which shows the corporation largely in debt to him) is fully set forth in Exception IV, transcript pp. 147-162. In this connection we wish to note the following clerical errors in the transcript:

The last column of table on pp. 157-8 and on p. 338 transcript, should be entitled: "Excess over *paving* bills collected by Rauer"; and the figure at bottom of first column should be *8,763.53* instead of *7,863.53*.

These tables and accompanying testimony and explanation and said exceptions show that Sunset Construction Company had grading bills and Rauer had paving against the same parties, and Sunset Company and Rauer were both collecting from them, sometimes Sunset collecting both for the grading and Rauer's paving, and sometimes Rauer collecting his paving and Sunset's grading, and that in the final windup of those joint collections Rauer received $40.00 less than his total paving bills; whereas the Master charged Rauer with the following as collections of Sunset's grading bills and made no allowance for paving bills collected by Sunset (transcript pp. 76 and 148.)

City warrant 495
Check of Hyman 750
" " " 250
" " Dufaw 20
" " Ryder 245
" " H. Meyer ..... 649—2,409.

But aside from the above, Hyman testified the checks for 750 and 250 had no reference to the grading work. (Transcript p. 324, also pp. 310-11), and the Ryder check for $245 is explained by the entry in the Sunset Construction book (transcript pp. 328-329 and 159), as follows:

"The Sunset Construction Company's books further show the following entries:
"Feb. 24, 1915, Received from Bauer check ..... $245.
Discount *on note* ..... 5.

$250.

"Assigned to J. J. Rauer note Ryder on 14th Avenue ..... $250."

This shows that instead of collecting Ryder's note directly from him the Sunset Construction Company went to Rauer, collected it from Rauer, allowing him a discount of $5.00, and then assigned the note to Rauer. The Sunset got Rauer's $245. in cash in exchange for the $250 note then and there, and now Rauer is directly to turn over the $250 to the trustee besides having already paid the Sunset $245.

The miscellaneous collections charged by the Master against Rauer (transcript p. 76) amounting to $1607.20, are made up of the following (Transcript p. 148):

Academy of Science	$300.	
Reeder and Ryder	407.20	
Bosworth	400.	
Iverson	500.	$1,607.20

These are fully analyzed on pp. 160, 161, 162 of transcript, and, as to two of the items, are shown to be moneys received by Rauer for work done after the Buckman bankruptcy, and as to the other two based on claims undoubtedly assigned before. See also transcript, pp. 309, 337, 338, 339, 160, 161, as to the Academy of Science $300; and as to the Reeder and Ryder $407.20, see pp. 161, 162, and Master's Report p. 75, stating this was "in full for *June team hire*" (folio 63). (The statement on p. 335 "in full for *Jan.* team hire" is a clerical error and should be *June.* This in *June, 1915,* four months after the bankruptcy.

Rauer was advancing moneys on contracts, and generally, to the Sunset Construction Co. right along and taking assignments. "Assignments were made to J. J. Rauer of all contracts of the Sunset Construction Company whenever he would lend any money on them, or advance any money for the bank." (Testimony of Filmore Buckman, transcript pp. 299 and 336-7); the last two collections fall under this category.

SECOND: THE APPEAL FROM THE ORDER OR DECREE ALLOWING TO H. M. WRIGHT, AS MASTER, A CERTAIN SUM OF MONEY FOR COMPENSATION AND DIRECTING THE SAME BE PAID BY APPELLANT, J. J. RAUER.

By the interlocutory decree the matter of the accounting was referred to H. M. Wright, Master in Chancery. (Transcript, pp. 15 and 16.)

Pursuant to the above decree an accounting was had before the Master and a report thereof was filed by him, and at the time of making his report the Master petitioned that his compensation be fixed by the Court. (Transcript, pp. 126-127.)

In this petition so signed and presented by the Master it is said:

> "Under all the circumstances, the Master believes and represents that a just compensation for his services would be the sum of five thousand (5,000) dollars and that said sum would be reasonable; that a minimum compensation would be forty-two hundred (4200) dollars. With respect to the party against whom it is charged, it is apparent that the usual practice of this court should be followed and that it should be charged against the accounting party, namely the defendant, J. J. Rauer. The justice of following the usual practice is apparent when it is considered that the Trustee in Bankruptcy is understood to have no funds in possession and the amount found due to him from the defendant Rauer ought not to be depleted to the loss of the creditors in bankruptcy.
>
> Wherefore, petitioner prays that this Court make its order fixing Master's compensation in the sum of five thousand (5000) dollars; that the amount to be paid by defendant J. J. Rauer, within ten (10) days from date of the order."

It is thus apparent that the Master was cognizant there would be no funds out of which his compensation of $5000 could be paid unless a judgment was entered against defendant Rauer. It could not be that the Master believed the plaintiff would pay the $5000 as the petition shows the Master knew the plaintiff was suing representatively as Trustee in Bankruptcy, and no funds belonged to the estate excepting such as might be recovered through a judgment in favor of the trustee and against Rauer in the matter of the accounting.

Defendant Rauer excepted to his report on the ground that the Master was disqualified, and also on the ground that the $5000 claimed as compensation was excessive. (Trancript, Exception VII to Report of Master, pp. 176-7.)

The District Court afterwards fixed this at $1800. Defendant Rauer assigned as error the disqualification of the Master, not only on the appeal from the order fixing the Master's compensation (Exceptions II and IV, Transcript, pp. 380-381), but also on the appeal from the judgment confirming the Master's Report and awarding judgment against defendant Rauer. (Transcript, Exception VIII, pp. 400-401.)

It is not the intent of counsel for Rauer to charge the Master with conscious bias or to say he was affected by the foregoing considerations.

It is a fact, however, that the Master had knowledge at the time he made his report that unless a judgment was entered against the defendant Rauer as recommended by the Master's report there would be no money available to pay the $5000 which the Master petitioned be allowed him for his service in making the report. This report was adopted by the Court and a judgment entered in accordance therewith.

It is true the Court denied the Master's petition that he be allowed $5000 for his service in making the report and reduced the amount of the allowance to $1800. This reduction by the Court of the sum asked for by the Master from $5000 to $1800 does not, however, meet the objection that when the Master submitted his report he petitioned for and anticipated receiving $5000, which only could be paid him if a judgment went against Rauer as recommended in the Master's report.

It is respectfully submitted that the judgment and orders appealed from should be reversed and judgment should be ordered in favor of appellant.

Dated, San Francisco,
October 22, 1923.

H. M. Anthony,
J. B. Zimdars,
William Grant,
Attorneys for Appellant.